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Government-Industry Advisory Panel
Tension Point Development

**Original Title:** *(1)(a) Difference in business plans between government and industry; (1)(b) Commercial return on investment over years versus sustainment, upgrades/modernization, and competition requirements; (1)(c) For-profit model versus non-profit business model conflict*

**Authors:** *Bill Elkington and Sean O'Brien*

**Tension Point:** There are fundamental conflicts within DoD's motivations regarding what it wants from industry, and because of industry's profit motives, there is a fundamental mismatch between what industry and DoD perceive their needs to be.

**Issue:** There is a fundamental conflict in DoD's motivation when it comes to innovative companies' IP. First, DoD wants to drive its costs lower and meet its needs for depot level capability through the acquisition of unusual IP rights. It sometimes tries to extract unusual (by commercial standards) IP rights in order to provide competition to companies that have invested in IP. The strategy sometimes is to try to take unusual IP rights and provide them to competitive product companies to lower the purchase price of the product. Or, even more frequently, it is to provide the innovative company's IP either to itself (in government operated depots), other aftermarket services providers, or other parts suppliers, and thereby reduce aftermarket program costs and meet other statutory requirements for depot work content. DoD program offices sometimes try to obtain these unusual rights at a price that is below the value of those rights by tying the IP transaction to a product purchase transaction.

In other words, DoD programs will sometimes attempt to achieve low cost and meet statutory depot requirements by tying the requirement for provision of unusual IP rights to a contract award for purchase of products or services, rather than relying solely on life-cycle-price competition from competing investing companies to drive cost down and rather than relying on public-private partnerships or other similar mechanisms to meet statutory depot requirements while providing reasonable aftermarket value to the investing company.

Second, DoD wants to encourage companies to invest in IP that matters to it and to make the fruits of that investment (in the form of innovative products and services) available to DoD. For most private sector companies, and as a matter of fiduciary duty for publicly traded companies, investment decisions are made based on the expected return on investment. In some industries relevant to the DoD's mission (e.g., aerospace), the return on investment often comes through aftermarket/sustainment activities rather than the initial original equipment sale. Therefore, over the long term, both traditional and non-traditional DoD suppliers will be less likely to make their innovation available to DoD, or continue to invest at current levels, or both, if their IP rights are made available to competitors, because to do so will typically destroy value. Providing an innovative company's IP to competing enterprises will usually reward non-investing companies and punish investing companies by providing sales and profits to non-investing companies, while reducing the risk-adjusted returns of the innovative companies; ultimately an investing company's enterprise value will diminish to the point that needed credit and investment is driven into avenues where the expected return on investment is greater.

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**Commented [RDH1]:** The DoD has a constitutional obligation to provide for the Nation's defense. Congress has passed legislation e.g., the various Titles of United States Code and Federal Code of Regulations, and the DoD is duty bound to comply with the law. One such law is to maximize competition and it is recognized that there are specific exceptions to competition. So, yes one of the goals is to minimize the cost of goods and services. The DoD seeks to purchase goods and services specific to meeting warfighter needs. When we purchase equipment, we have to be prepared to operate it and sustain it over its life-cycle. Depot maintenance is not the only thing we are seeking data for.

**Commented [RDH2]:** If you define "unusual" as data that a commercial entity is unwilling to give to another commercial entity fine. If you define "unusual" as requesting data rights/licenses that Congress has established for the Federal Government then this should be rephrased.

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**Commented [RDH3]:** The DoD 'requests' data and rights/licenses to that data we need to operate and sustain a product over its life cycle. We "evaluate" data rights/licenses to get best value. The use of the word "extract" implies a devious or underhanded intention that does not exist in the DoD.

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**Commented [RDH4]:** The United States Congress and the President of the United States have passed law(s) that provide for certain rights to selected forms of data (call them default rights). The DoD requests data to meet the missions assigned by the President and we either ask for the default rights to that data or we negotiate for a different level of rights. One such law that the DoD must comply with is maximizing competition subject to the 7 exceptions. If the default data rights/licenses allow us to compete that is not "unusual" in doing business with the DoD.

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**Commented [RDH5]:** The DoD seeks the data along with the associated rights/licenses to operate and sustain an item or software over its life cycle. Once again, Congress and the President have passed laws that the DoD must comply with. While these laws might not apply to commercial firms doing business with commercial firms, they do apply to doing business with the DoD.

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**Commented [RDH6]:** I believe the authors need to review the history of legislative actions taken by Congress and the President relative to organic depot level maintenance. The so called 50/50 rule and public-private-partnerships have been intended to provide a 'balance' between maintaining both an organic industrial capability and a commercial industrial capability. You are questioning the legitimacy of the DoD's needs for data and the associated rights/licenses to provide for National Defense. The DoD, has a statutory obligation to acquire, equip, train, and maintain military equipment and software.

**Commented [RDH7]:** I shudder to think that we are trying to rewrite 10 USC 2320 and 2321 around a particular industry, e.g. aviation. The DoD has an enormous number of equipment and software that are not fixed wing or rotary aircraft. In the Army, t…

**Commented [RDH8]:** I'm sorry, but I thought our mission was to find a balance between the legitimate interests of both industry and the DoD, but you aren't even recognizing in this white paper that the DoD has a legitimate interest in data. That's wrong!

**DRAFT**

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Tension Point Development

The issue is this: In view of private sector business models, the DoD's use of tying tactics and monopoly power may provide DoD with unusual IP rights in the short term, which enables DoD to reduce its costs for some period of time and meet its statutory depot requirements, but over the long term, such a strategy will drive away the very companies DoD looks to for innovation. Alternatively, if DoD only sought unusual (by commercial standards) IP rights in the areas it actually needs and were willing to fully compensate the IP investing company for the value of those rights (and budget for the purchase of those rights), it would encourage traditional and non-traditional suppliers to make investments in IP it cares about, over the long term.

**Recommendation:** Make changes to the DFARS that would require:

1. DoD acquisition of rights to privately funded and commercial IP—outside of the implied license rights purchased in the products and services offered for sale, themselves—shall be done in such a way that DoD pays full value for those rights.
2. The valuation of such unusual rights shall be assessed in accordance with best practices and industry standards and norms by experts in the field of IP valuation.
3. DoD shall only acquire rights to privately funded and commercial IP that it actually needs to perform its mission.
4. If DoD uses the cost of obtaining rights to privately funded and commercial IP to disadvantage a bidder in a procurement, it must show to a panel of IP valuation and financial analysis experts that its preferred solution would be less expensive than the disadvantaged bidder's solution over the product's life cycle.

**Cross-reference to other Tension Points:**

- **Section 3 (Source Selection Concerns), Subsection b.**

**Notes on Paper**

- Make Changes to paper to show clear statutory and policy recommendations
- Experts should include government/industry personnel (IP Valuation model)
- Include expanded solution of SNLR
  - SNLR balances bargaining power issue
  - GPR/unlimited creates sense of not solid IP strategy
- Cover both Industry and Government Business Models
- Note funding challenges up front (i.e. privately funded vs mixed funding)
- Any list of recommendations should include the need of OMIT data
  - At depot level not getting what we need
  - Define some criticality of it
- In absences of competitive model, what is the model for fair and reasonable price
  - Utility model: how do we come to consensus to pricing model to define what is fair? Possibility is SNLR
- Industry needs to look at own behavior concerning IP rights (general comment)

**Commented [RDH9]:** Is this an issue or a plea? Industry has known the statutory constraints of doing business with the Federal Government and DoD for some time. It's not like all of a sudden we changed how we do business. The DoD operates within the confines of the DFARS in acquisition. Changes to the DFARS are open for public comment and rule making. These so called tactics and monopoly power are no different than they have ever been. You are attempting to use your IP as a forcing function to hold the DoD hostage to your prices and you leverage in bargaining/negotiation.

**Commented [RDH10]:** As determined by who?

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**Commented [RDH11]:** Current policy already states that we are to acquire the minimum data necessary to perform our mission.

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**Commented [RDH12]:** Are you really suggesting that the DoD allow a panel of IP valuation and financial experts to inform the decision making of the Source Selection Authority or the Milestone Decision Authority?

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Tension Point Development

- Expand to three business models
- For Recommendation #1:
  - In the RFP, what is your data rights strategy and why do you need that data (baseline thought through up front in the acquisition life cycle)
  - Clear preference for SNLR; Addition of other License Rights
  - Change “Full” to “Fair” “While encouraging competition”
- For Recommendation #2:
  - How is unusual defined? Add uniqueness of Warfighter requirements
- Recommendation #3: Increasing trend in Government asking for GPR. DoD might want to study that.
  - Look to recommendations in 6c, 2a, etc
- Recommendation #4:
  - Evaluate the value of IP to the government

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